



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS
AND BUSINESS REGULATION
DIVISION OF ENERGY RESOURCES

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July 27, 2005

Mary L. Cottrell, Secretary
Department of Telecommunications & Energy
One South Station, Second Floor
Boston, Massachusetts 02110

Re: Bay State, D.T.E. 05-27: Response to Information Request

Dear Ms. Cottrell:

On behalf of the Massachusetts Division of Energy Resources, please find attached the responses to the following Information Requests of Bay State Gas Company:

BSG-DOER-1-1 BSG-DOER-1-2 BSG-DOER-1-3

Thank you for your attention to this matter.

Sincerely,

Robert F. Sydney
General Counsel

Cc: Caroline Bulger, Hearing Officer (2 copies)
Paul E. Osborne, Asst. Director – Rates and Revenue Requirements Div. (1 copy)
Andreas Thanos, Asst. Director, Gas Division (1 copy)
A. John Sullivan, Rates and Revenue Requirements Division (2)
Service List (1 electronic copy)

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

RESPONSE OF DIVISION OF ENERGY RESOURCES TO THE
FIRST SET OF INFORMATION REQUESTS FROM BAY STATE GAS COMPANY

Date: July 27, 2005

Responsible: Alvaro E. Pereira, Manager of Energy Supply and Pricing, DOER

BSG-DOER-1-1 Please refer to the Pereira Testimony at p. 5, lines 18-19. Please replicate the passages (complete sentences, without ellipses) in Dr. Kaufmann's response to DTE-4-2, where he states that "focusing on O&M costs provides a 'complete evaluation of utility managers' cost performance." Do the referenced sections of Mr. Pereira's testimony provide an accurate restatement of Dr. Kaufmann's response? Please explain.

Response: The complete sentence from Dr. Kaufmann's response is as follows:

"Nevertheless, focusing on O&M costs still provides a good and nearly complete evaluation of utility managers' cost performance."

The only difference between the quote in Dr. Pereira's testimony and Dr. Kaufmann's response is the exclusion of "good and nearly" before "complete" in Mr. Pereira's testimony. This omission is not significant and does not change the meaning of what Dr. Kaufmann stated or the point made by Dr. Pereira in quoting it.

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Responsible: Alvaro E. Pereira, Manager of Energy Supply and Pricing, DOER

- BSG-DOER-1-2 Refer to Mr. Pereira's testimony, page 9 lines 18-26 regarding Mr. Pereira's recommended earnings sharing mechanism (ESM).
- a. Please explain precisely how the recommended ESM "returns any initial productivity gains going forward back to consumers" (lines 22-23). Please provide a hypothetical example of how such "initial productivity gains" will be shared with customers.
 - b. Please provide examples of other energy utilities that operate under an ESM similar in form to the mechanism described in the response to a).
 - c. Explain how the recommended ESM is consistent with having a "bandwidth" of 200 basis points around allowed ROE.

Response:

- a. Productivity gains result from more efficient use of inputs relative to outputs and can be measured in cost savings. Indeed, it can be argued that the major benefit of a PBR is to reduce costs through more productive use of inputs by attempting to mimic market forces. Cost savings increase profits and, ultimately, returns to shareholders, hence there are incentives for management to search for productivity gains in well-designed PBRs. In a free market environment, cost savings eventually get passed onto consumers due to competitive pressures. A well-designed PBR should account for this market occurrence, and an ESM is one mechanism. The recommended ESM would return any excess earnings to ratepayers in the same manner as the Company's proposed ESM. The key difference is that ratepayers would actually receive some of the benefits from the PBR plan because ratepayers would be eligible for savings a lot sooner than under the Company's proposal.

Assume the following for the hypothetical example:

1. Total Equity of Company = \$2 billion
2. ROE or benchmark = 10%
3. Bandwidth = 200 basis points.
4. Sharing = 75% Shareholder/25% Ratepayer Split After Bandwidth
5. Actual ROE = 13%

Under these assumptions, the company would credit ratepayers \$45 million—calculated as $((0.12 - 0.10) * 100\% + (0.13 - 0.12) * 25\%) * \2 billion —and retain the remainder (\$215 million) of the actual ROE.

By contrast, implementation of the Company's proposed ESM under these assumptions would result in \$0 credited to ratepayers.

b. I know of no energy utilities that operate exactly under the mechanism described in a). There have been examples of ESMs that have returned productivity gains to ratepayers (see, for example, page 23 of Dr. Kaufmann's response to DTE-4-44). There have also been examples of progressive ESMs (see entries 1 and 3 in Exh. DOER-AEP-1).

c. There are no issues of inconsistency. The recommended ESM operates akin to a threshold the Company must meet before sharing in excess earnings above the benchmark. Such an ESM is more effective in inducing companies who are superior cost performers to seek the remaining, most difficult cost-cutting measures that may be available (see Pereira testimony at 9, lines 8-15).

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DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

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Responsible: Legal Department, DOER

BSG-DOER-1-3 Provide a statement of DOER's purpose and the constituency for whom DOER advocates.

Response: DOER is the Massachusetts executive agency responsible for establishing and implementing the Commonwealth's energy policies and programs, generally. (M.G.L. c. 25A, § 6). Pursuant to M.G.L. c. 25A, § 6, DOER is authorized and directed to: 1) plan, develop, oversee, and operate programs to help consumers understand, evaluate, and select retail energy supplies and related services offered as a consequence of electricity and gas utility restructuring; 2) develop and administer programs relating to energy conservation, demand-side management, alternative energy development, non-renewable energy supply and resources development, energy information and energy emergencies; 3) advise, assist, and cooperate with other state, local, regional, and federal agencies in developing appropriate program and policies relating to energy planning and regulation in the Commonwealth; 3) develop energy data and information management capabilities to aid energy planning and decision-making.

DOER is organizationally within, and subject to the direction of, the Massachusetts Office of Consumer Affairs and Business Regulation. (G.L. c. 25A, sec. 1). As such, it seeks to protect Massachusetts consumers (our constituents) by identifying and addressing practices, costs, and investments made by regulated energy companies that may adversely impact consumers. It further acts to promote fair and honest competition in the energy sector while providing consumers with accurate information on the costs associated with their energy resources.